FILE COPY

FILED
MAR 23 1959
JAMES R. BROWNING, Clerk

No. 714

In the Supreme Court of the United States

OCTOBER TERM, 1958

MADISON FUND, INC. (Formerly The Pennroad Corporation) and AFFILIATED COMPANIES, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
Solicitor General,

CHARLES K. RICE,
Assistant Attorney General,

A. F. PRESCOTT,
GEORGE W. BEATTY,
Attorneys,
Department of Justice,
Washington 25, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Argument	8
Conclusion	11

CITATIONS

CASES:

Alabama Mineral Land Co. v. *Commissioner*, 250 F. 2d 870	10
Camp v. *Murray*, 226 F. 2d 931	10
Chandler v. *United States*, 226 F. 2d 403	8, 9, 10
Cluck v. *Commissioner*, No. 701, this Term	10
Corn Products Co. v. *Commissioner*, 350 U.S. 46	9
Curtis Co. v. *Commissioner*, 232 F. 2d 167	9, 10
Dillon v. *Commissioner*, 213 F. 2d 218	10
Dougherty v. *Commissioner*, 216 F. 2d 110	8
Galena Oaks Corp. v. *Scofield*, 218 F. 2d 217	10
Goldberg v. *Commissioner*, 223 F. 2d 709	8
Greenspon v. *Commissioner*, 229 F. 2d 947	8
Home Co. v. *Commissioner*, 212 F. 2d 637	8
Kaltreider v. *Commissioner*, 255 F. 2d 833	8
King v. *Commissioner*, 189 F. 2d 122, certiorari denied, 342 U.S. 829	9
Lakin v. *Commissioner*, 249 F. 2d 781	8, 10
Philber Equipment Corp. v. *Commissioner*, 237 F. 2d 129	9
Phipps v. *Commissioner*, 54 F. 2d 469	8
Pool v. *Commissioner*, 251 F. 2d 233, certiorari denied, 356 U.S. 938	9
Riedel v. *Commissioner*, 261 F. 2d 371	9
S. E. C. Corp. v. *United States*, 241 F. 2d 416, certiorari denied, 354 U.S. 909	9
Shearer v. *Smyth*, 221 F. 2d 478, certiorari denied, 350 U.S. 840	9
Slatkin, Harry, Builders v. *Commissioner*, 235 F. 2d 189, certiorari denied, 352 U.S. 928	9

Page

Smith v. *Dunn*, 224 F. 2d 353 9
Stockton Harbor Indus. Co. v. *Commissioner*, 216 F. 2d 638, certiorari denied, 349 U.S. 904 ..... 8, 9
Three States Lumber Co. v. *Commissioner*, 158 F. 2d 61 10
Yunker v. *Commissioner*, 256 F. 2d 130 ..... 9, 10

STATUTES:

Internal Revenue Code of 1939:
Sec. 22(a) (26 U.S.C., 1952 ed., Sec. 22(a)) 2
Sec. 117(a) (26 U.S.C., 1952 ed., Sec. 117(a)) 2, 8

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 714

MADISON FUND, INC. (Formerly The Pennroad Corporation) and AFFILIATED COMPANIES, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 60a-84a)[1] are reported at 29 T.C. 914. The opinion of the Court of Appeals (Pet. 27-36) is reported at 261 F. 2d 325.

JURISDICTION

In each of these two consolidated cases, the judgment of the Court of Appeals was entered on November 26, 1958. (Pet. 37.) The petition for a writ of certiorari was filed on February 20, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

[1] Record references are to the Appendix to taxpayer's brief in the Court of Appeals.

QUESTION PRESENTED

Whether real estate sold by the taxpayer was property held primarily for sale to customers in the ordinary course of trade or business.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property * * *.

* * *

(26 U.S.C. 1952 ed., Sec. 22)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 210(a), Revenue Act of 1950, c. 994, 64 Stat. 906] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section

23(l), or real property used in his trade or business;

* * *

(26 U.S.C. 1952 ed., Sec. 117)

STATEMENT

The facts as found by the Tax Court (R. 62a-78a) and summarized by the Court of Appeals (Pet. 27-31) may be stated as follows:

Taxpayer is an investment company which filed consolidated returns during the years 1950-1952 for itself and certain affiliated companies. One of these affiliates was the Canton Company of Baltimore, hereinafter referred to as Canton. Taxpayer owned over 99 per cent of Canton's stock, and in turn, Canton owned all of the stock of the Canton Railroad Company and 98 per cent of the stock of the Cottman Company. (R. 62a.) The real estate sales giving rise to this litigation were made by Canton. (R. 73a.)

Canton was incorporated by a special act of the Maryland legislature in 1828. Its charter authorizes it to purchase, hold, improve and dispose of real or personal property in accordance with the purposes for which it was formed. These purposes included the improvement of land in the Baltimore area, and the leasing or selling of such land to persons who would use it for agricultural, mining, manufacturing or commercial purposes. (R. 62a-63a.) Canton Railroad performs switching services between the industries located on its right of way, the Baltimore waterfront, and the three trunk lines servicing the city. (R. 64a.) The Cottman Company is a stevedoring company which performs stevedoring operations for Canton Railroad and other companies using

facilities leased from Canton and Canton Railroad. (R. 66a.)

Shortly after its creation in 1828, Canton acquired approximately 5,000 acres of land located in and near Baltimore, fronting on and adjacent to the Patapsco River. In keeping with the purposes of its organization, Canton began improving and selling its real estate. Some, if not all, of these improvements were with a view to the continued holding and use of the property improved. The improvements included the construction of waterfront facilities, such as docks, wharves and piers. By 1835 Canton's real estate sales had amounted to $93,618.50. (R. 63a-64a.)

From time to time, in the course of its operations, Canton has purchased additional parcels of real estate. (R. 64a.) Its 1912 annual report to its stockholders announced the purchase of about 100 acres for "future development." The described purpose for the purchase of various parcels was to "straighten boundary lines" of parcels already owned. A dominant, if not the primary, purpose of the purchases so described was to fill out or shape up irregular parcels which Canton was holding for sale, so as to make them more attractive to customers who were or might be in the market for industrial sites. Some of the purchases to straighten boundary lines were as much as 30 to 50 acres. (R. 65a.) In connection with a proposed extension of the Canton Railroad, Canton in 1912 purchased 16 parcels of real estate along the proposed route. The plan was later abandoned and in 1925 Canton's board of directors directed that the right of way of 100 feet in width should be disposed of at the president's discretion. (R. 65a-66a.)

During World War I the United States Government constructed three or four warehouses on property belonging to Canton. After the war, Canton acquired the warehouses from the Government and since that time one of its activities has been the leasing of warehouse space to about twenty tenants for manufacturing and storage purposes. (R. 66a.)

Over the years, and in keeping with the purposes for which it was organized, Canton has regularly carried on a program of improving portions of its property for continued use in its operations, while selling or marketing other portions. The development of the Port of Baltimore has always been a matter of special interest to Canton, and from the beginning, it has devoted particular attention to both the current and future improvement and development of its waterfront property. In making a sale of land to the Western Electric Company in 1929, Canton reserved a long strip of land to protect its riparian rights, thereby making it possible to add to its waterfront terminals when the appropriate time should come. The Canton Railroad has likewise been a strong influence in Canton's operations. Since the projection and construction of the railroad, Canton has made it a practice to sell land regarded as suitable for industrial uses only to purchasers which it thought would be traffic producers for the railroad. Sales of land not suitable for industrial use have not been so restricted, and a large percentage, if not most, of such sales have been for residential sites. To make the land held for sale more readily marketable, Canton would at times lay out and grade streets and otherwise develop a particular area in which it had land for sale. (R. 67a.)

Canton did not list its property with brokers, nor did it employ brokers or agents to dispose of its property. The prices for property were fixed by one of its officers subject to approval by its board of directors, such prices being comparable to what other sellers of similar property were receiving. (R. 68a.)

Although no "For Sale" signs were posted by Canton, it did, from time to time, prepare and issue brochures and maps describing its operations and available real estate. It also advertised locally in magazines, newspapers, and telephone directories. Rather consistently Canton described itself as dealing in "Industrial Real Estate." At times it also indicated that it had large or small tracts available to builders for residential purposes. (R. 69a-71a.)

In 1930, after one hundred years of operations, Canton's real estate holdings were approximately 1,700 acres. Thereafter Canton continued selling real estate at a reasonably steady rate up to and including the taxable years. (R. 68a.)

During 1950, 1951, and 1952, the taxable years in question, thirty-three sales were consummated for an income tax profit of $293,949.19[2] A substantial number of the parcels were from the original acquisition of 5,000 acres; others were acquired as part of the plan to extend the Canton Railroad, and still others or portions thereof were acquired for the purpose of "straightening boundary lines." With the exception of two parcels, all of the land was unimproved and only one-third of the parcels had been rented at any

[2] Canton realized a book profit on each of the sales made during the taxable years, but on eleven of the sales it realized no gain for income tax purposes, because the selling price did not exceed March 1, 1913 value or cost. (R. 73a.)

time during the preceding ten years, most of them for outdoor advertising or farming operations at nominal rentals. (R. 73a-76a.)

For federal income tax purposes, Canton always treated gains from the sales of its real estate as capital gains, and this was not questioned by the Government until 1949. Taxpayer's consolidated returns for the taxable years in question described Canton's business as "Real Estate—Active." During 1940-1950 the taxpayer stated in its annual reports to its stockholders that "Canton Company of Baltimore was chartered in Maryland in 1829 [*sic*] for the purpose of dealing in real estate, etc. The principal business is the sale and/or rental of real estate." Canton's annual reports for 1951 and 1952 referred to the land that had been sold as "unimproved land which had been held for many years as an investment." Its annual reports for the immediately preceding years contained no such statement. (R. 77a-78a.)

On the basis of the foregoing facts, the Tax Court concluded (R. 78a-84a) that the property sold by Canton was held primarily for sale to customers in the ordinary course of Canton's business. In reaching this conclusion, the Tax Court stressed the evidence showing the purpose for which Canton was formed, the advertising that was done, the purchases which Canton made to straighten boundary lines, the continuity and regularity of the sales, and finally, the development of facilities by Canton to serve the industrial buyers of Canton's property. (R. 80a.)

After carefully reviewing the facts (Pet. 27-31), the Court of Appeals reached the same conclusion. In addition to the factors stressed by the Tax Court, the Court of Appeals pointed (Pet. 36) to taxpayer's

description of Canton's business in taxpayer's annual reports and on its tax returns.

ARGUMENT

The question presented is one of fact, and the court below correctly affirmed the Tax Court's determination. There is no conflict and no occasion for further review.

1. Section 117(a)(1)(A) of the Internal Revenue Code of 1939 (*supra*, pp. 2-3) denies preferential capital gain treatment to gain from the sale of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Whether particular property falls within this category is a question of ultimate fact in each case, and no one factor is controlling. Among the relevant factors to be considered are the nature of the taxpayer's business, the taxpayer's intention or purpose in acquiring and holding the property, the frequency and continuity of sales, the methods used to promote sales, and the relationship which the sales bear to the taxpayer's other business activity, if any.[3]

On the basis of the facts summarized *supra*, the Tax Court was fully warranted in concluding (R. 78a) that the real estate sold by Canton during the years 1950-1952 was held primarily for sale to customers in the

[3] The appellate decisions in this area are legion, and they hold that each case rests on its own particular facts. See, *e.g.*, *Kaltreider* v. *Commissioner*, 255 F. 2d 833, 837-838 (C. A. 3d); *Lakin* v. *Commissioner*, 249 F. 2d 781 (C.A. 4th); *Greenspon* v. *Commissioner*, 229 F. 2d 947, 951-953 (C.A. 8th); *Chandler* v. *United States*, 226 F. 2d 403, 406 (C.A. 7th); *Goldberg* v. *Commissioner*, 223 F. 2d 709 (C.A. 5th); *Stockton Harbor Indus. Co.* v. *Commissioner*, 216 F. 2d 638, 650-651 (C.A. 9th), certiorari denied, 349 U.S. 904; *Dougherty* v. *Commissioner*, 216 F. 2d 110 (C.A. 6th); *Home Co.* v. *Commissioner*, 212 F. 2d 637 (C.A. 10th); *Phipps* v. *Commissioner*, 54 F. 2d 469 (C.A. 2d).

ordinary course of Canton's business. Under familiar rules governing the scope of judicial review, the Court of Appeals was equally justified in sustaining this factual determination. Both courts below having decided the factual issue against taxpayer, their concurrent findings are entitled to finality here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51. Indeed, this Court has declined to review cases which presented comparable fact questions[4], and, because of the inappropriateness of Supreme Court review in cases of this kind, the Government has refrained from seeking certiorari where the decision has been adverse to it.[5] There is no more occasion for review of this case than of the other similar cases.

2. There is no conflict. Since the question is factual, each case in this field turns, as it must, on its own record. In view of the variations in the evidentiary content of such cases, differences of result are not only inevitable, but appropriate. Certainly, there has been no suggestion that any one factor is, or should be controlling. Thus, the fact stressed by the taxpayer that it sold certain property without reinvesting the pro-

[4] See, *e.g.*, *Pool* v. *Commissioner*, 251 F. 2d 233 (C.A. 9th), certiorari denied, 356 U.S. 938; *S.E.C. Corp.* v. *United States*, 241 F. 2d 416 (C.A. 2d), certiorari denied, 354 U.S. 909; *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6th), certiorari denied, 352 U.S. 928; *Shearer* v. *Smyth*, 221 F. 2d 478 (C.A. 9th), certiorari denied, 350 U.S. 840; *Stockton Harbor Indus. Co.* v. *Commissioner*, *supra*; *King* v. *Commissioner*, 189 F. 2d 122 (C.A. 5th), certiorari denied, 342 U.S. 829.

[5] See, *e.g.*, *Riedel* v. *Commissioner*, 261 F. 2d 371 (C.A. 5th); *Yunker* v. *Commissioner*, 256 F. 2d 130 (C.A. 6th); *Philber Equipment Corp.* v. *Commissioner*, 237 F. 2d 129 (C.A. 3d); *Curtis Co.* v. *Commissioner*, 232 F. 2d 167 (C.A. 3d); *Chandler* v. *United States*, 226 F. 2d 403 (C.A. 7th); *Smith* v. *Dunn*, 224 F. 2d 353 (C.A. 5th).

ceeds in similar property is not, in itself, decisive of the issue.[6] Taxpayer contends (Pet. 15-17, 20, 21-22) that because Canton did not reinvest its sales proceeds in similar land, the decision below is in conflict with decisions of the Sixth, Seventh, and Eighth Circuits. However, each of the cases relied on by taxpayer was decided on the basis of its own facts, and in each instance the facts were substantially different from those involved here.[7]

Nothing in any of these decisions suggests that capital gains treatment must or should be accorded to the sales proceeds in every case where assets are liquidated with a minimum amount of business activity. The nature and purpose of the original acquisition; the change, if any, in the taxpayer's use of the assets;

---

[6] Cf. *Cluck* v. *Commissioner*, pending on petition for a writ of certiorari, No. 701, this Term. Cf. *Lakin* v. *Commissioner*, 249 F. 2d 781 (C.A. 4th), with *Camp* v. *Murray*, 226 F. 2d 931 (C.A. 4th). Cf. *Alabama Mineral Land Co.* v. *Commissioner*, 250 F. 2d 870 (C.A. 5th), with *Galena Oaks Corp.* v. *Scofield*, 218 F. 2d 217 (C.A. 5th).

[7] Thus, *Yunker* v. *Commissioner*, 256 F. 2d 130 (C.A. 6th), involved the sale of undeveloped land which the taxpayer had inherited from her relatives. When the taxpayer's broker was unable to sell all 75 acres as a single tract, for a reasonable price, the land was divided into smaller parcels and a road was built to provide access to these parcels. Emphasizing these facts, the court decided that the sales proceeds were taxable as capital gains (256 F. 2d, p. 136). In *Chandler* v. *United States*, 226 F. 2d 403 (C.A. 7th), the taxpayer was engaged in cattle ranching until the business became unprofitable at which point the live stock was sold and a decision was made to liquidate the land holdings. Stressing the fact that the lands were not purchased for the purpose of resale, the court held that "the specific facts established in this case warrant capital gain treatment for taxpayer's transactions." (226 F. 2d, p. 406.) *Three States Lumber Co.* v. *Commissioner*, 158 F. 2d 61 (C.A. 7th), is to the same effect, and see also, *Dillon* v. *Commissioner*, 213 F. 2d 218 (C.A. 8th); *Curtis Co.* v. *Commissioner*, 232 F. 2d 167 (C.A. 3d).

and the amount of business activity in disposing of the assets are all relevant in determining whether the taxpayer is in the "business" of selling such assets. In a case like the present one, where the taxpayer acquired land for the purpose of improving and selling it, and has been selling it ever since under the circumstances set forth *supra*, no conflict is created by a decision taxing the sales proceeds as ordinary income.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

A. F. PRESCOTT,
GEORGE W. BEATTY,
Attorneys.

March, 1959

U. S. GOVERNMENT PRINTING OFFICE 1959—500103/P.O. 1191